

**Review of the Submitted Budget
For Fiscal Year 2004**

March 2003

City Auditor's Office

City of Kansas City, Missouri

March 5, 2003

Honorable Mayor and Members of the City Council:

The City Manager's submitted budget does not fully fund major city priorities, is precariously balanced and sets the stage for mid-year adjustments to keep revenues and expenditures in balance.

I am virtually certain that the City will need to make adjustments to the 2004 budget early in the year in order to keep revenues and expenditures in balance. The city has had to make mid-year adjustments before, including in the current year, but the adjustments in the coming year will be harder to make because this year's budget is tighter.

Without room to make adjustments, the city is likely to have to cut services in ways that will hurt groups of people. For example, the city might reduce spending by laying off city employees, hurting those employees and reducing services; or closing community centers, hurting the people who go to those centers; or charging for trash service, costing residents money.

The city's current budget difficulties reflect both an economic downturn and long-term structural problems. Last year we wrote that the city had increased spending over the past two decades without significantly reallocating resources from low to high priorities. For example, without reallocating resources – without structural changes – the city increased capital spending in the 1990's by adding new revenue sources. In the last two years, the city added sales taxes to fund public safety rather than reallocate funds from lower priorities. Short-term measures used to balance previous budgets resulted in deferred costs that the city is facing now.

This report analyzes the 2004 submitted budget and presents a set of options for reducing expenditures or increasing revenues. While the set of options we present is not exhaustive, we examine a wide range of possibilities for saving money or increasing revenue. Each option carries some risk and involves a significant change in how the city does business. Making changes, however, could improve the city's financial condition.

In previous budget reviews we made recommendations, but in this one we do not. We think it is appropriate for the Mayor and City Council to discuss and consider each of the options. If they feel an option merits further analysis – such as determining how to implement the option – the Mayor and Council should direct staff to do further analysis and make specific recommendations.

We appreciate the assistance of management staff in providing information for our analysis. The team for this project was Anatoli Douditski, Michael Eglinski, Amanda Noble, Sue Polys, Joan Pu, Julia Terenjuk, and Vivien Zhi.

Mark Funkhouser
City Auditor

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Introduction

Objectives

This review of the City Manager's submitted budget for fiscal year 2004 was conducted pursuant to Resolution 911385. The resolution directs the City Auditor to annually review and comment on the City Manager's budget.

This year's review focuses on the overall financial condition of the city and some options to reduce expenditures or increase revenues.

This is our thirteenth budget review.

Scope and Methodology

We conducted this audit in accordance with generally accepted government auditing standards, with the exception of reporting the views of management concerning the audit. However, we have discussed the conclusions and contents of the report with the City Manager. Our methods included:

- Reviewing the City Manager's preliminary and submitted budgets.
- Updating analyses from prior budget reviews.
- Interviewing city staff.
- Reviewing prior audit work and other reports to identify budget options.

No information was omitted from this report because it was deemed privileged or confidential.

Analysis

The City Manager's submitted budget does not fully fund major city priorities and is precariously balanced. In addition, mid-year adjustments are likely in 2004; however, making the adjustments will be difficult because there is little flexibility. Financial indicators identify weaknesses in the city's financial condition. Weak financial condition can cause services to suffer and poor service can, in turn, further weaken financial condition. We identify a number of options that the Mayor and City Council could consider to save money or increase revenue.

Fund Balance Further Eroded and Capital Deferred

The City Manager's submitted budget does not meet the Council's policy goals for fund balance or capital spending. Maintaining adequate fund balance and increasing spending on deferred maintenance, policies to strengthen the city's financial condition, are not addressed in the submitted budget.

The City Manager recommends reducing the general fund balance to 3.4 percent, well below the Council's target of 8 percent. Fund balance declined for the fourth year in a row and is at the lowest level since 1989. The fund balance provides a financial cushion in the event of a loss or decline of revenue, economic downturns, unanticipated emergencies, and uneven cash flow. Because the fund balance is so low, the city is in a poor position to respond to financial problems in the coming year.

The City Manager also recommends decreasing spending on deferred maintenance despite the Council policy of increasing spending on deferred maintenance and a need to address capital maintenance in the city. In 2004, the city plans to spend \$36.3 million of the capital budget on deferred maintenance, about \$6 million less than was budgeted for the current year. The Council policy calls for increasing spending by \$5 million each year. Deferring capital maintenance saves money in the short run but creates higher costs in the long run.

Balance Is Precarious

The 2004 submitted budget reflects a precarious balance. The budget is "tight" meaning relatively small increases in expenditures or decreases in revenues would be difficult to address. The balance is "precarious" meaning that small changes could have immediate negative

consequences. For example, relatively small unexpected expenditures could require the city to make mid-year expenditure adjustments.

The City Manager's budget counts on significant savings from the retirement incentive program but the savings are uncertain, depending on the extent to which people are hired to fill positions of retirees. In addition, the loss of staff could affect programs adversely. The submitted budget does not accurately reflect the program-level effects because the budget was put together before the City Manager knew who was going to retire. In the submitted budget, the positions of people who retire are randomly assigned to specific programs. The actual effects on specific programs will depend on decisions by individual employees eligible to retire.

The City Manager's budget counts on revenue growth that is uncertain. For example, the budget includes \$1.2 million in fees for some solid waste services that have not been approved. Traffic fines are expected to increase substantially. Earnings tax revenue is expected to grow 4.5 percent despite general uncertainty about the economy. Meeting these, and other, revenue expectations remains uncertain. Because the budget is "tight" and the fund balance is low, the effect of relatively small differences between revenue estimates and actual revenue could be significant.

Mid-Year Adjustments Will Be Difficult

As in 2003, the city is likely to face mid-year adjustments, but making these adjustments will be more difficult than it has been in the past because the city has little flexibility. Financial indicators show limited financial flexibility and budget actions already taken – such as eliminating vacant positions and reducing expenditures through retirements – have further reduced immediate flexibility.

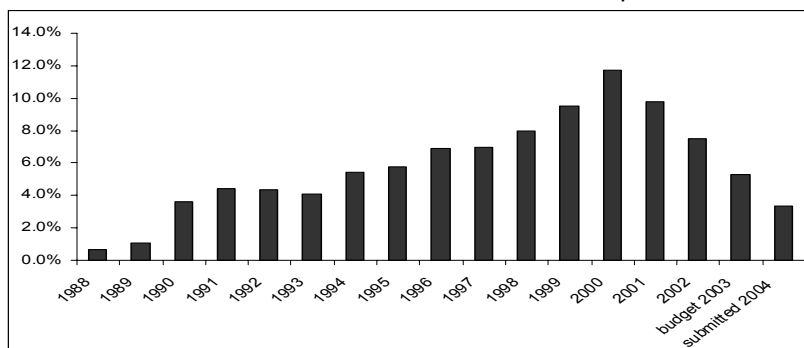
In 2003, the city made mid-year adjustments to keep the budget in balance. Those adjustments included implementing the retirement incentive program, freezing hiring, deferring maintenance, allowing employees to take voluntary furloughs, and reducing departmental expenditures on contract employees and tuition reimbursement. As a result of these actions and reductions in the submitted budget, departments will have less flexibility to make mid-year adjustments in 2004.

Financial Indicators Identify Weaknesses

Indicators of the city's financial condition show weaknesses. The fund balance is low, some capital spending is deferred, financial flexibility is low, taxes were increased and added, and the structural imbalance remains. Weak financial condition can cause services to suffer.

General fund balance as a percent of expenditures is down for the fourth year in a row and is lower than it has been since 1989. Decreasing fund balance diminishes the city's ability to respond to uneven cash flow or unexpected emergencies such as disasters. (See Exhibit 1.)

Exhibit 1. General Fund Balance As a Percent of Expenditures



Sources: Adopted Budgets 1989-2003 and Submitted Budget 2004.

While capital improvement spending as a percent of the general municipal budget increased in the mid 1990s, spending remains below the 20 percent goal, which the Community Infrastructure Committee recommended and the City Council adopted in 1997. (See Exhibit 2.)

Exhibit 2. Capital Spending in Millions and As a Percent of General Municipal Budget

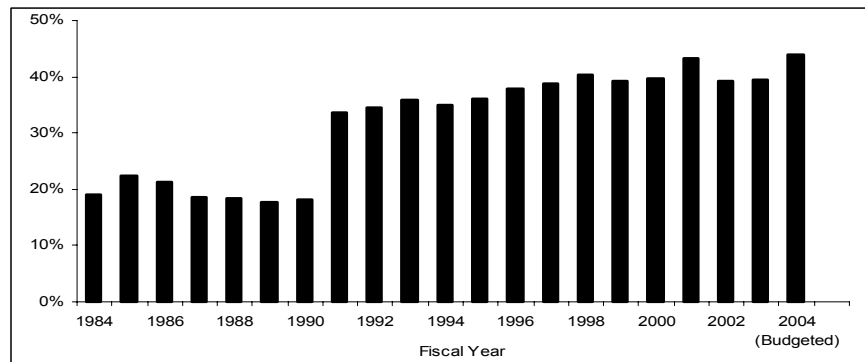
Fiscal Year	General Municipal Expenditures	Capital Improvement Expenditures	Percent
1982	262.6	25.7	9.8%
1983	265.3	19.5	7.3%
1984	274.5	15.5	5.7%
1985	293.9	26.2	8.9%
1986	328.0	36.3	11.1%
1987	333.2	35.8	10.7%
1988	349.7	39.9	11.4%
1989	356.1	39.9	11.2%
1990	373.2	35.2	9.4%
1991	398.9	40.1	10.1%
1992	417.4	40.4	9.7%
1993	428.1	40.8	9.5%
1994	443.4	38.9	8.8%
1995	441.4	53.3	12.1%
1996	493.6	66.0	13.4%
1997	512.3	60.8	11.9%
1998	547.9	71.6	13.1%
1999	584.3	77.0	13.2%
2000	589.7	78.3	13.3%
2001	699.2	121.5	17.4%
2002	686.9	91.4	13.3%

Sources: Adopted Budgets 1989-2003 and Submitted Budget 2004.

In the last two years, two new sales taxes that will fund capital for public safety became effective. These taxes are expected to fund about \$28 million in capital in 2004. In August 2002, voters approved issuing general obligation bonds for a total of \$35 million that will be used to fund capital. (See Appendix A for a chart showing new revenues by effective date, from 1980 through 2003.)

Over 40 percent of operating revenues are earmarked for specific uses by state laws, bond covenants, city ordinances, or grant requirements. (See Exhibit 3.) The City Council has less flexibility to respond to changing priorities and unforeseen conditions because restricted revenues are high. This year's budget includes the first full year of the public safety sales tax – a new restricted revenue.

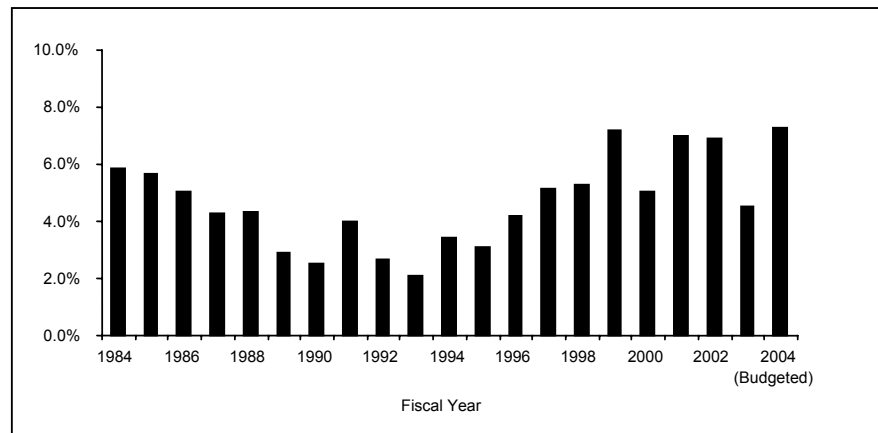
Exhibit 3. Restricted Revenue As a Percent of Operating Revenue



Sources: Adopted Budgets 1989-2003 and Submitted Budget 2004.

Since the early 1990s, transfers from the general fund have generally increased. (See Exhibit 4.) Net general fund transfers are another measure of flexibility. Increasing general fund transfers reduce financial flexibility as some dedicated revenues do not keep pace with the cost of providing the programs they are intended to provide.

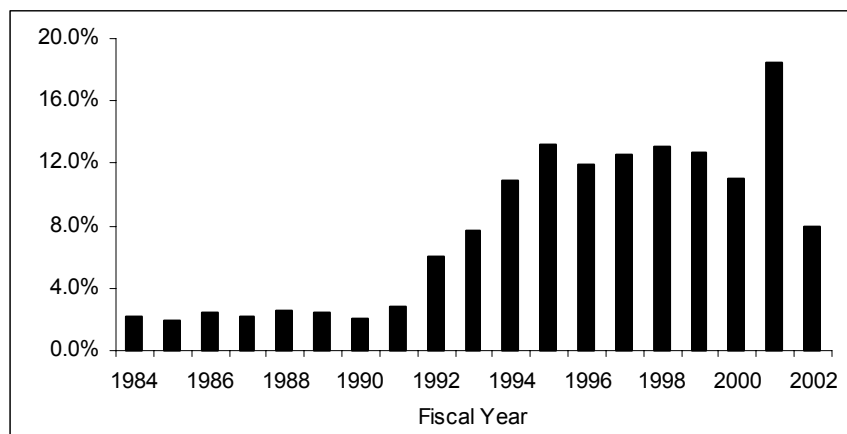
Exhibit 4. Net General Fund Transfers As a Percent of General Fund



Sources: Adopted Budgets 1989-2003 and Submitted Budget 2004.

Debt service as a percent of operating revenue was eight percent in 2002, well below the 20 percent level considered a warning level and below the 10 percent level considered acceptable by financial experts. Over the last ten years, the level of debt has generally been just over 10 percent. (See Exhibit 5.) In 2001, debt was 18 percent, mostly due to refunding Public Safety and Zoo Improvement Bonds and retiring Special Obligation Revenue Bonds.

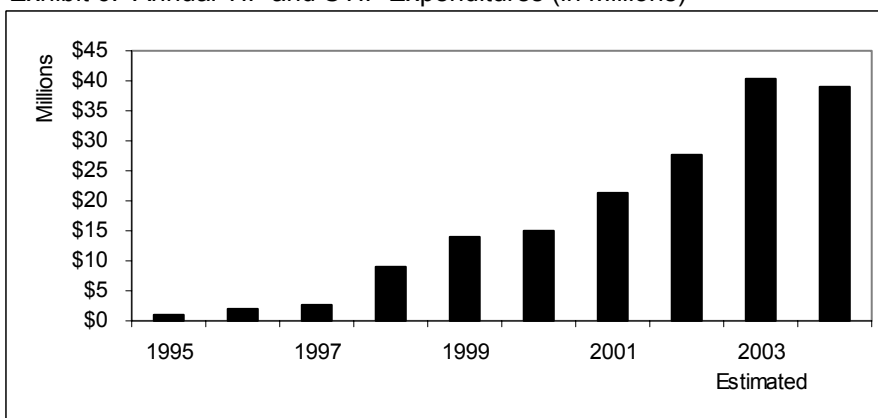
Exhibit 5. Debt Service As a Percent of Operating Revenue



Sources: Adopted Budgets 1989-2003 and Submitted Budget 2004.

Since the mid 1990s, TIF and STIF expenditures have grown significantly and have become a significant city expenditure. (See Exhibit 6.) TIF and STIF budgeted expenditures for 2004 are a bit below the estimated expenditures for 2003 and remain a significant portion of the budget.¹

Exhibit 6. Annual TIF and STIF Expenditures (in Millions)



Sources: Adopted Budgets 1989-2003 and Submitted Budget 2004.

¹ TIF and STIF budget for 2004 does not include reserve funding and is based on expectations of declining economic activities. The City Manager's budget is lower than the estimates for 2004 provided to the city by the Economic Development Corporation, the agency that provides staff support to the TIF Commission.

The structural imbalance remains. The imbalance will be eliminated when:

- Current revenue and current expenditures are in balance;
- An adequate fund balance is maintained;
- Maintenance expenditures are not deferred; and
- Expected revenue growth is equal to or greater than expenditure growth in coming years.

The submitted budget does not meet these conditions. The 2004 submitted budget uses \$6.3 million of carryover to pay for ongoing expenditures; reduces fund balance to less than half of what it should be; defers capital maintenance; and continues to anticipate annual expenditure growth that is higher than revenue growth in the coming years.

Weak financial condition can cause services to suffer and poor service can, in turn, further weaken financial condition. The structural imbalance weakens the city's ability to provide services. When the city faces a structural imbalance, common strategies – such as deferring capital and using fund balance – make it harder for a city to provide services at adequate quantities and qualities. Poor public services can erode the tax base, weakening financial condition, and make it even harder to deliver services.

Options for Reducing Costs or Increasing Revenues

The City Auditor's Office identified a number of options for reducing costs or increasing revenues. While the list is not exhaustive, it includes a wide range of possibilities for saving money or increasing revenue. Each option carries some risk and involves a significant change in how the city does business. Making changes, however, could help improve the city's financial condition.

We identified options by reviewing prior audit work, interviewing city staff and reviewing work from other jurisdictions. We identified 11 options that are further discussed in this report. We developed a simple framework to help ensure we looked at a range of options. (See Exhibit 7.) In examining each option, we identified arguments that proponents and opponents might make.

Exhibit 7. Budget Options Addressed in the Report

Is the financial effect large?	Can the financial effect of the option be felt soon?	
	Yes	No
Yes	Lay off employees Reduce pay and the workweek Defer wages Reduce extra spending on boulevards	Sell parks and community centers Charge for trash service Eliminate occupation licenses and increase profits tax Implement public/private competition Fund new TIF projects with PILOTs only
No	Reduce take-home cars Consolidate city and Police network and PC support	

While we don't recommend specific options, we think it is appropriate for the Mayor and City Council to consider each of them. If the Council feels the options merit further analysis – such as determining how to implement them – the Council should direct staff to do further analysis and make specific recommendations. The Mayor and City Council should also consider other options because the options we identified are not exhaustive.

We hope this report will spur discussion and debate; begin a process of considering major, structural changes to the city's budget; and help the Mayor and Council strengthen the city's financial condition.

Lay Off Employees

The city could cut spending by reducing the number of city employees. Reducing the number of employees could be done by across-the-board layoffs or targeted layoffs. Across the board layoffs would affect all departments and could include public safety employees. Targeted layoffs would affect programs that are lower priority.

The option is available to the city; however, city code sets forth procedures governing workforce reduction. The existing layoff ordinance contains provisions including order of layoffs, exceptions to the normal order of layoff, employee notification, and transfer, bumping, reinstatement, and recall procedures. These provisions might impact the effectiveness of the option as an alternative. Offering employees severance packages also could diminish the financial impact of this alternative.

Financial effect: This option could save about \$30,000 in salary and benefits per employee laid off.

Proponents might argue that layoffs would provide instant savings relieving budget pressure. Layoffs are cheap to implement. Those in favor may also say that targeted layoffs would eliminate nonessential programs, channeling more funding for basic services.

Proponents also could argue that a well-planned, well-communicated workforce reduction process that involves employees and focuses on long-term, strategic changes is a successful downsizing tool. Downsizing as a part of organizational transformation and providing transition services to employees could mitigate the negative impact of job loss.

Opponents might argue that layoffs would disrupt the delivery of basic services, such as water, sewer, solid waste, and street maintenance. And to generate the desired savings, many smaller programs might have to be eliminated.

Opponents also may argue that layoffs don't fix problems created by poor management. Opponents also might argue that layoffs cause financial hardship to employees who lose their jobs. And because of bumping rights, savings would come from eliminating low-level employees. Those opposing could also say that balancing the budget on the backs of city employees can "backfire," leaving behind a demoralized workforce.

Reduce the Pay and Workweek for Employees by Two Hours

The city could reduce payroll costs by reducing the workweek to 38 hours. This would reduce the pay of affected employees by five percent. Some services such as police, fire, solid waste, and municipal correction officers or agencies that are facing serious staff shortages could be exempt from the program. Such exemptions however, would reduce the savings generated from implementing this option.

If implemented, the program would produce an annual reduction in personal services costs. Payroll is the highest operating expense to the city. In fiscal year 2004 personal services expenditures are budgeted at about \$370 million, comprising about 38 percent of the total budget. The city, however, would have to bargain with the unions over the impact and implementation.

Financial effect: This option could save the city about \$71,000 per week or \$3.7 million a year.

Proponents might argue that reducing the work week would save money without having to lay off employees. Compared to layoffs, reducing the work week spreads the pain over a larger group of employees and might be better for employee morale.

Opponents might argue that reducing pay would hurt employee morale. Reducing the workweek would also lower productivity. Those opposing may also say that adjusting workloads to preserve services would be difficult and that overtime cost could go up.

The savings generated are equivalent to about 125 avoided layoffs. The proponents might also say that the option lowers payroll cost while maintaining service delivery and employment for the city workforce.

Defer Wages for Employees

The city could defer some of its payroll costs. The city would withhold the equivalent of one week's salary per year from city employees, thus deferring the payroll costs. The employees would receive the deferred pay when the city's fiscal condition improved or when the employees left the city service. The implementation of this option would depend on capabilities of the city's financial accounting system.

Payroll is the highest operating expense to the city. In fiscal year 2004 personal services expenditures are budgeted at about \$370 million, comprising about 38 percent of the total budget. If implemented, the program would produce a temporary reduction in personal services costs. The city, however, would have to bargain over the impact and implementation of the option with the unions.

Financial effect: The city could defer about \$5.4 million in salary expenditures to future years.

Proponents of deferring wages might argue that it saves money while sparing the hardships of layoffs. Those in favor may also say that savings would be generated without reducing services. Unlike no-work/no-pay options employees would eventually recover their pay.

Opponents might argue that tracking deferred compensation would increase administrative expenses offsetting some of the benefits. Opponents may also say that reduced salary would impose financial hardship on city employees. Wage deferral would hurt employees' morale and lower productivity. Those opposing may also say that the proposal does not generate recurring savings to the city.

Maintain Green Spaces on Boulevards With the Front Foot Tax Only

The city could pay for maintaining the green spaces on boulevards and parkways with the front foot tax and eliminate the general fund spending in this area. The city spends more money than is generated by the front foot tax to maintain the green space along boulevards and parkways. The front foot tax is levied (\$1 per foot) on land abutting boulevards, parkways, roads, and highways for the purpose of maintaining, repairing, and otherwise improving the boulevards, parkways, roads, and other highways under the jurisdiction of the Parks and Recreation Department. In fiscal year 2004, the tax is estimated to cover only about a fourth of the boulevard services provided by the department.

Currently, the Parks and Recreation Department maintains the boulevards' green space by mowing; applying herbicides; planting and maintaining trees, shrubs and floral displays; operating and maintaining irrigation systems and specialized lighting; and removing litter. Most of the spending is for mowing and removing litter. Reducing these service levels to only those which can be paid by the front foot tax would not impact street repair and maintenance of roadways under the jurisdiction of the Board of Parks and Recreation Commissioners because Public Works provides those services.

Financial effect: Limiting spending to the front foot tax revenue would save about \$1.5 million a year, the difference between the 2004 budgeted expenditures and front foot tax revenues.

Proponents might argue that reducing spending is a matter of equity or fairness. Currently, citizens along the boulevards get more city services than other residents and they only pay a fourth of the cost. All Kansas City residents contribute to the additional 75 percent of boulevard expenses. Proponents may also point out that the city charter says that the front foot tax will be used for maintaining, repairing, and otherwise improving the boulevards and parkways. However, it does not identify what services will be provided.

Opponents might argue that reduced spending on boulevards will hurt Kansas City's identity which is, in part, linked to its boulevards. Additionally, opponents may argue that all residents use the boulevards in the city, not just those whose land abuts it; therefore everyone should share the cost to maintain the boulevards. And, although the charter does not specifically prescribe the services that must be provided with the front foot tax, citizens paying the tax may feel that this change in policy breaks prior service level commitments.

Reduce Take-home Vehicles

The city could reduce the number of employees who are assigned take-home cars. City departments and the Police Department have invested about \$30 million in acquiring over 2,000 passenger vehicles. City regulations permit take-home vehicle assignments for employees who are frequently required to answer emergency calls during both business and non-business hours.

The City Auditor's Office reported that 223 city passenger vehicles and 374 Police Department passenger vehicles were assigned as take-home units in November, 2000. The City Manager reported in August, 2001 that the city had reduced the number of take-home cars by 27. Reimbursing actual mileage for after hours use of personal vehicles for employees who infrequently respond to emergency or call-back activities could save \$444,000 annually. Reducing the number of take-home vehicles will also reduce the acquisition costs.

Financial Effect: The City Auditor's Office estimated in its report of *Citywide Management of Take-Home Vehicles* in November, 2000, that reducing take-home vehicles could save \$444,000 each year. The capital outlay will also be reduced when the number of take-home vehicles is reduced.

Proponents might argue that almost half the mileage accumulated on take-home vehicles comes from commuting, at a cost of over \$1 million a year. Assigning take-home vehicles increases vehicle operating costs, adds mileage to vehicles, and decreases the pool of vehicles available to cover operational needs. By eliminating unwarranted take-home vehicle assignments, the city and Police Department could reduce ongoing vehicle costs, reallocate passenger vehicle fleet resources, not replace unneeded vehicles, and reduce the city's liability from accidents. In addition, citizens view take-home vehicles as a perk provided to city employees or police officers to drive between home and work.

Opponents might argue that police officers and city employees need take-home vehicles rather than relying on availability of personal cars so they can respond quickly to emergencies. Faster response time could save lives, especially in critical incidents like a World Trade Center type of disaster.

Providing take-home vehicles saves money by reducing the administrative costs of paying reimbursements for employees using personal vehicles. It also removes an unnecessary or unfair burden on employees who are frequently required to answer emergency calls.

Consolidate City and Police Department Computer Network and PC Support

The city could provide computer network and PC support to the Police Department. Although the city and the Police Department are separate entities with different legislative mandates, there are no legal barriers to consolidation. The city and the Police Department would have to enter into an inter-governmental cooperative agreement to do this.

Financial Effect: Consolidation will mostly provide long-term savings from avoiding duplicate investments in information technology.

Proponents might argue that consolidation will save money. It would provide the Police Department with access to the city's client server network, e-mail, and Internet service, eliminating the need for building a duplicate infrastructure. The city and the Police Department have plans for significant investments in information technology. Consolidation of resources will allow them to avoid high start-up costs for specialized facilities, equipment, or personnel. Consolidation would provide a low-risk opportunity to improve communication and build trust between the two entities. Information technology consolidation would lay groundwork for more cooperation between the city and the Police Department.

Opponents might argue that consolidation will lead to a loss of service quality, negative impact on employees, and friction between the city and the Police Department. The time and resources required to manage the transition might exceed original estimates. The Police Department has concerns about the city's ability to ensure the security of data and the ability to provide good service.

Sell Some City Parks and Community Centers

The Parks and Recreation Department could sell or give to non-profits some of the city's parks and community centers to save on maintenance and upkeep. There are about 200 parks and 11 community centers in Kansas City. The city spends more money on parks and community centers than is available from dedicated funding sources and user fees. Selling some of the city's parks and community centers will save maintenance funds. Voters must approve selling parks or community centers.

Financial Effect: Savings would primarily be achieved by spending less money on maintenance because there will be fewer parks and community centers to maintain. Cutting parks and community centers related expenditures by 25 percent would save the general fund about \$6.1 million. Sales of parks and community centers could produce some revenue and make these properties subject to property tax.

Proponents might argue that few people attend parks and community centers. Citizen surveys show that almost half of Kansas City households never visited a park, and over sixty percent never used a community center or a recreation program.² There is not enough money to adequately maintain all parks and community centers, which are beset with widespread maintenance problems.³

Opponents might argue that closing parks and community centers would make neighborhoods less desirable. New owners of parks and community centers may start charging for recreation programs pricing them too high for local residents. Selling means losing control of public assets. As an alternative, opponents suggest changing the design of existing parks where larger sections would remain undeveloped and reducing the number of amenities the city has to maintain. Another alternative is to lease community centers.

² *City Services Performance Report for Fiscal Year 2002*, Office of the City Auditor, Kansas City, Missouri, March 2003 (forthcoming).

³ *Parks and Recreation Department Community Centers*, Office of the City Auditor, Kansas City, Missouri, April 2002, and *Park Conditions*, Office of the City Auditor, Kansas City, Missouri, November 2002.

Charge for Trash Service

The city could charge households for waste collection. Modeling the program after a utility the city would charge residents according to the amount of refuse they throw away. Cities across the country have implemented a variety of such programs that use bags, tags, or cans to measure the amount of waste generated by a resident.

Currently the Solid Waste division provides for trash collection to residents at no charge. Trash collection costs are estimated to be about \$7.8 million in 2003. The city also provides a bulky item pickup service with 12 pickups each calendar year and a leaf and brush collection service three times a year. The city also operates leaf and brush drop-off centers. These programs' cost in 2003 is estimated at \$2 million. Collection for all waste collection services is provided for dwellings with six or fewer units. All programs are funded from general tax dollars.

The city also pays about \$1.3 million annually in rebates to apartment owners and mobile home developments. Charging for trash collection would remove the legal requirement to make these payments.

Financial effect: The city could generate about \$10 million by introducing a fee-based refuse collection, bulky item collection, and leaf and brush collection services. Eliminating rebates to apartment owners and mobile home developments would save over \$1 million a year.

Proponents might argue that that a fee-based system discourages wastefulness and would reduce trash volume sent to landfill. It provides an economic incentive to recycle.

Proponents also may argue that the fee-based approach is equitable, since residents pay only for what they throw away. Additionally, other cities' experiences are that illegal dumping does not increase when a fee-based system is started.

Proponents may also say that if the city wants to raise new revenue, a fee-based collection system is a fair way to do so. The system would be easy to implement if it were modeled after a utility.

Opponents might argue that imposing new fees would be difficult. In the early seventies, the city "promised" free trash collection services to its residents. In 1970 the city increased the earnings and profits tax to raise funds for various purposes including instituting a weekly, city-wide residential trash collection service. Opponents may argue that a fee-based service would increase illegal dumping.

Opponents also could argue that the fee-based system shifts a burden to low-income families and that high cost of enforcement and education would offset some of the benefits.

Eliminate Occupational License and Increase Profits Tax

The city could eliminate occupational licenses and increase profits tax. An occupational license is a business privilege tax imposed on individuals or entities conducting business in the city. The city's charter contains a list of business types subject to the tax. The listing has not been updated since the 1950's; therefore, new firms such as technology-based businesses are not included. Certain types of businesses are exempt by state statute. While the majority of businesses are required to pay the tax based on annual gross receipts, there are over 130 different fee schedules for other businesses.

The occupational license is expensive to administer. The Mayor's Task Force for Occupational License reported in 1996 that the cost of administering the occupational license is about \$500,000, or almost 5 percent of the revenue it generates, compared to a less than 2 percent administrative cost on the earnings tax.

The profits tax is part of the earnings tax imposed on the net profits of all resident unincorporated businesses, as well as all non-resident unincorporated businesses and corporations performing work in Kansas City, Missouri.

Financial Effect: The total revenue of the occupational license and profit tax is budgeted at about \$36 million (\$17 million and \$19 million, respectively) in fiscal year 2004. Increasing the total revenue by 10 percent could generate about \$3.6 million.⁴

Proponents might argue that the current system of occupational license is inefficient and expensive for the city to administer. It is also inconsistent and inequitable for businesses. Eliminating occupational licenses means less hassle for businesses. The business listing is outdated, which results in many businesses not having to pay the tax. Many of the fee schedules for the occupational license are old and don't keep up with inflation.

Profits tax is easier for businesses to understand and for the city to administer as it has a more simple structure. Eliminating occupational licenses and increasing profits tax ensure a consistent tax structure across all businesses.

Opponents might argue that increasing the profits tax requires a statutory change by the state legislature, City Council action, and a vote of the citizens of Kansas City. Even if the option could be implemented, it would take a long time.

Eliminating the occupational license may jeopardize utility taxes which are expected to generate over \$60 millions in fiscal year 2004.

In addition, increasing the profit tax increases businesses' tax burden. Currently, some businesses are exempt from occupational license and pay limited profit tax.

⁴ In 1996, a Mayor's task force proposed a revenue neutral change by eliminating the occupation license, increasing the profits tax to 1.3 percent, and imposing a minimum profits tax of \$250. Increasing revenue would have required a higher tax rate, a higher minimum tax, or both.

Implement Public/Private Competition

The city could implement competition between city departments and the private sector, known as “public/private competition.”⁵ In this form of contracting, city departments and private sector companies bid to provide public services at the lowest cost. Some governments realized significant savings and improved services by using public/private competition.

Financial effect: The financial effect can not be estimated but would depend on the level of competition, potential for efficiency gains, and the scope of services subject to competition.

Proponents might argue that competitive bidding between the public and private sectors for delivery of government services has been used in a number of jurisdictions to improve performance and reduce costs. Unlike privatization methods, competitive contracting is not based on the assumption that public sector service delivery is inherently inefficient. Competition, rather than organizational structure, is the key to efficiency. By introducing competition into the public sector, competitive bidding challenges government to carefully examine its use of resources and provide services most efficiently.

Opponents might argue that not all contracting experiences have been successful. A number of governmental agencies have had difficulties with poor performance on contracts and cost overruns. In addition, the process will hurt morale among city employees. They would fear for their job security and city health and pension benefits if public/private competition is implemented. City employees – usually trained only to provide services, not to compete in the marketplace – would need help to formulate and execute successful bids. Public/private competition is a drastic measure that should not be used until other steps have been taken to improve efficiency.

⁵ *A Model for Public/Private Competition*, Office of the City Auditor, Kansas City, Missouri, August 1996.

Fund New TIF Projects With PILOTs Only

The city could limit the funding source for new TIF projects to payments in lieu of taxes (PILOTs), which are based on the increased property values within the TIF district. Currently state law also allows a portion of economic activity taxes (EATs) to be used to pay for development costs in TIF areas. Economic activity taxes include sales, earnings, profits, and utility taxes. In fiscal year 2002, the city used \$14.7 million in EATs to pay for TIF and STIF projects.

Unlike increased property values, increased economic activities are not always clearly linked to investment in a geographic area. If sales or earnings that were already occurring in other parts of the city are shifted to the TIF district, the project is capturing tax revenue that would otherwise be available to fund city services. Proponents and opponents disagree on the extent to which this shifting occurs.

Financial Effect: The financial effect depends on the number and type of TIF projects approved. Long term savings are possible.

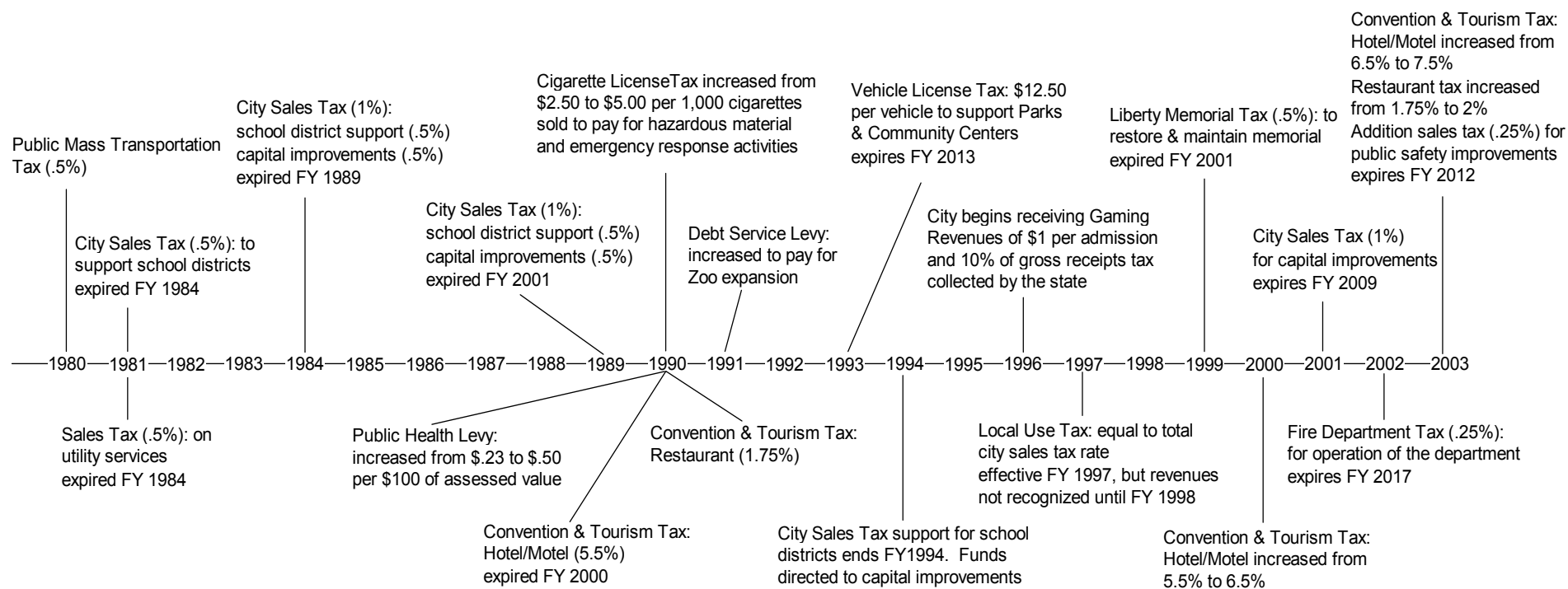
Proponents might argue that TIF usually applies only to the property tax. The theoretical basis for TIF is that property tax revenue generated by improving an area is used to pay for public improvements with the same area. Most (39 of 48) states that authorize TIF base funding on PILOTs and do not provide for use of other taxes such as sales, earnings, and utility taxes. These other taxes are less suited to TIF because it is difficult to determine the increment that is due to development incentives when economic activity moves from one part of the city to a TIF area, or general economic conditions change. While the City Council must find that development would not occur without TIF, this “but-for” test has been focused on each specific proposal rather than the general development potential of the area. The “but-for” test does not address the extent to which economic activities are shifted from one area of the city to a TIF district.

Opponents might argue that projects financed through TIF pay for themselves. State law requires developers to prove that projects would not be built, “but for” the TIF incentives; therefore, the projects add to the existing tax base. TIF adds to the store of total public infrastructure in the city in a cost-effective way by using public dollars to leverage private investment. While it is possible that a new TIF project could attract existing retail sales, thereby capturing previous city sales tax revenue as new TIF revenue, a policy to limit TIF funding to PILOTs would hurt the city’s ability to compete with other cities. The city should continue to consider the merits of each project. The public infrastructure made possible by TIF often creates a more attractive environment, so that total sales taxes generated after such a move are significantly higher than those generated in the earlier non-TIF plan area location.

Appendix A

Chart Showing New Revenues by Effective Date (1980 – 2003)

New Revenue by Effective Date



Sources: Kansas City, Missouri Ordinances, Revised Statutes of Missouri, and Comprehensive Annual Financial Reports 1980-2001.

